INDEX.

	Page
Opinions Below	1
Jurisdiction	2
Question presented	2
Statutes and Regulations involved	2
Statement	2
Argument	6
Conclusion	30
Appendix A	31
Appendix B	35

CITATIONS.

Cases:

Mrs. Frank Andrews, 26 B.T.A. 642 23
Apex Hosiery Co. v. Leader, 310 U.S. 469 27
Bazley v. Commissioner, 331 U.S. 737 16
Stanley D. Beard, 4 T.C. 756 11
Brown v. Allen, 344 U.S. 443 26
Silas H. Burnham, 29 B.T.A. 605 ..... 11, 12
Channing v. Hassett, 200 F. 2d 514 9
Chapman v. United States, 63 Ct. Cls. 106, cert. denied, 275 U.S. 524 11
Chisholm v. Commissioner, 79 F. 2d 14, cert. denied, 296 U.S. 641 ..... 8, 17, 19, 21
Choate v. Commissioner, 129 F. 2d 684 11
Commissioner v. Beck's Estate, 129 F. 2d 243 ..... 29, 30
Commissioner v. Estate of Church, 335 U.S. 632 26
Commissioner v. Court Holding Co., 324 U.S. 331 ..... 15, 23
Commissioner v. Culbertson, 337 U.S. 733 14
Commissioner v. Gilmore's Estate, 130 F. 2d 791 22
Commissioner v. Korell, 339 U.S. 619 ..... 8, 30
Commissioner v. Munter, 331 U.S. 210 11
Commissioner v. Phipps, 336 U.S. 410 11
Commissioner v. Sansome, 60 F. 2d 931, cert. denied, 287 U.S. 667 15

Page

Charles M. Cooke, Ltd., 2 T.C. 147 8
Deputy v. du Pont, 308 U.S. 488 15
Dodd, Mead & Co., 43 B.T.A. 739, aff'd, 123 F. 2d 145 11
Doerschuck v. United States, 274 Fed. 739 17
Eisner v. Macomber, 252 U.S. 189.....6, 7, 11, 13, 25, 27
Founders General Co. v. Hoey, 300 U.S. 268..... 18
General Utilities Co. v. Helvering, 296 U.S. 200..18, 19, 21
Graves v. N. Y. ex rel. O'Keefe, 306 U.S. 466..... 16
Gregory v. Helvering, 293 U.S. 465 17
Helvering v. Gowran, 302 U.S. 238.....7, 30
Helvering v. Griffiths, 318 U.S. 371.....6, 7, 11, 15, 25, 27
Helvering v. National Grocery Co., 304 U.S. 282.... 9
Helvering v. Sprouse, 318 U.S. 604.....6, 24, 25, 27
Helvering v. Tex-Penn Co., 300 U.S. 481.....19, 20, 21
Estate of Elise W. Hill, 10 T.C. 1090 18
Insull v. Commissioner, 87 F. 2d 648 11
Jeffries v. Commissioner, 158 F. 2d 225, cert. denied, 330 U.S. 843 18
John Kelley Co. v. Commissioner, 326 U.S. 521..... 17
Koshland v. Helvering, 298 U.S. 441 .....7, 24
Lilly v. Commissioner, 343 U.S. 90 14
Lonsdale v. Commissioner, 32 F. 2d 537, cert. denied, 280 U.S. 575 23
Miles v. Safe Deposit Co., 259 U.S. 247 7
Minnesota Tea Co. v. Helvering, 302 U.S. 609..... 22
National Carbide Corp. v. Commissioner, 336 U.S. 422 14
Palmer v. Commissioner, 302 U.S. 63..... 11
Powers v. Commissioner, 312 U.S. 259 14
Estate of Putnam v. Commissioner, 324 U.S. 393... 10
Screws v. United States, 325 U.S. 91..... 27
Estate of Joseph E. Sorg, 1 T.C.M. 879 8
Starr v. Commissioner, 82 F. 2d 964, cert. denied, 298 U.S. 680 19
Stern v. Commissioner, 32 A.F.T.R. 1737, rev'g 46 B.T.A. 416 8
Steubenville Bridge Co., 11 T.C. 789 21
Strassburger v. Commissioner, 318 U.S. 604 6, 8, 24, 25, 27
Emil H. Strassburger, 1941 P.-H. B.T.A. Memo. Dec. ¶ 41,098 24
Toolson v. New York Yankees, 346 U.S. 356..... 27

Page

Estate of Emanuel Ulman, 46 B.T.A. 517, aff'd sub nom Citizens & Southern Nat. Bank v. Commissioner, 136 F. 2d 684, cert. denied, 320 U.S. 752... 21
United States v. Arcade Company, 346 U.S. 828.... 16
United States v. Cumberland Public Service Co., 338 U.S. 451.....9, 15, 20, 21, 22, 23
United States v. Cummins Distilleries Corp., 166 F. 2d 17 21
United States v. Nunnally Investment Co., 316 U.S. 258 30
Wall v. United States, 164 F. 2d 462 18
Walling v. Halliburton Co., 331 U.S. 17 27
Rodman Wanamaker Trust, 11 T.C. 365, aff'd, 178 F. 2d 10 11
Daisy M. Ward, 29 B.T.A. 1251, petition dismissed, 79 F. 2d 381 12
Watts v. Indiana, 338 U.S. 49 14
Weiss v. Wiener, 279 U.S. 333 11
Wilgard Realty Co. v. Commissioner, 127 F. 2d 514 23
Woodruff v. Commissioner, 131 F. 2d 429 21

STATUTES:

Individual Income Tax Act of 1944, Pub. L. No. 315, 78th Cong., 2d Sess. (1944) 28
Internal Revenue Code:
Sec. 27(b)(f)(i) 27
Sec. 102(d)(2) 27
Sec. 112(g)(1)(E) 16
Sec. 113(a)(19)(A) 7, 8, 27
Sec. 115(a).....6, 10, 11
Sec. 115(f) 6, 13, 27
Sec. 115(h) 27
Sec. 115(j) 17
Sec. 117(a) 8, 12
Sec. 117(b) 12
Sec. 117(c) 8, 12
Sec. 117(h)(5) 7, 8, 12, 13, 27
Sec. 335 27
Sec. 362(b)(2) 27
Sec. 441(d) 27
Sec. 458(d)(f) 27

Page

Sec. 504(a)(c) 27
Sec. 506(c) 27
Revenue Act of 1942, 56 Stat. 802, Sec. 102..... 4
Revenue Act of 1943, Pub. L. No. 235, 78th Cong., 2d Sess. (1944) 28
Revenue Act of 1945, Pub. L. No. 214, 79th Cong., 1st Sess. (1945) 28
Revenue Act of 1948, Pub. L. No. 471, 80th Cong., 2d Sess. (1948) 28
Revenue Act of 1950, Pub. L. No. 814, 81st Cong., 2d Sess. (1950) 28
Revenue Act of 1951, Pub. L. No. 183, 82d Cong., 1st Sess. (1951) 28
Technical Changes Act of 1949, Pub. L. No. 378, 81st Cong., 1st Sess. (1949) 28
Technical Changes Act of 1953, Pub. L. No. 287, 83d Cong., 1st Sess. (1953) 28

MISCELLANEOUS:

American Law Institute, Federal Income Tax Statute, p. 224 (Tent. Draft No. 7, 1952) 29
Darrell, Recent Developments in Nontaxable Reorganizations and Stock Dividends, 61 Harv. L. Rev. 958, 961 (1948) 26
G.C.M. 8751, X-1 Cum. Bull. 219 (1931) 11, 12
Holmes, The Common Law, p. 110 (1881) 8
Mim. 4963, 1939-2, Cum. Bull. 459 26
Rev. Rul. 10, 1953-2, Cum. Bull. 18 26
T. D. 4027, VI-1 Cum. Bull. 164 (1927) 11

Treasury Regulations 111:

Sec. 29.113(a)(12)-1 7
Sec. 29.113(a)(19)-1 .....7, 28
Sec. 29.115-1 6
Sec. 29.115-10 17
Sec. 29.117-4 .....8, 28

Treasury Regulations 118:

Sec. 39.113(a)(19)-1 28
Sec. 39.117(h)-1(b) 28
U. S. Const., Sixteenth Amendment 6, 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 530

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

C. P. CHAMBERLIN[1]

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 51-73) is reported in 18 T. C. 164. The opinion of the Court of Appeals (R. 91-103) is reported in 207 F. 2d 462.

---

[1] Together with *Commissioner of Internal Revenue, Petitioner* v. *Grace A. Chamberlin; Commissioner of Internal Revenue, Petitioner* v. *John H. Toner; Commissioner of Internal Revenue, Petitioner* v. *Benjamin James Carl; Commissioner of Internal Revenue, Petitioner* v. *Guy V. Schrock; Commissioner of Internal Revenue, Petitioner* v. *Robert Pierce and Josephine H. B. Pierce.*

JURISDICTION

The judgments of the Court of Appeals were entered on October 14, 1953. (R. 87-91.) The petition for writs of certiorari was filed on January 11, 1954. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

The stockholders of a corporation received a dividend of preferred stock on common stock, which was the only class of stock then outstanding. The receipt of the preferred shares did not in any way change the pre-existing proportionate interests of the stockholders. The question is whether the preferred stock was nevertheless a taxable dividend because the stockholders sold the stock shortly after its distribution.

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and regulations appear in Appendix A, *infra*.

STATEMENT

The facts in the main are stipulated and they are not in dispute.[2] They may be summarized as follows:

In 1946 the taxpayers were stockholders in Metal Mouldings Corporation,[3] which makes metal mouldings and bright work trim used in the manufacture of automobiles. From 1940 until December 20, 1946, the issued and outstanding common stock totalled 1,002½ shares. C. P. Chamberlin and his wife, Grace, together owned 83.8 percent of the

---

[2] The Commissioner erroneously argues that the Court of Appeals substituted its own "inferences of fact for those of the Tax Court." (Pet. 9.) See further p. 13, *infra*.

[3] Our references to the respondent taxpayers do not include Josephine H. B. Pierce, since she was not a stockholder in the corporation. The Commissioner has asserted a deficiency against her because she filed a joint return with her husband, Robert Pierce, for the taxable year in question. (R. 41, 56.)

stock. The business of the corporation prospered. Between 1937 and 1945 its net earnings, after taxes, were $2,751,913.07, and it paid substantial cash dividends aggregating $1,604,000. As of June 30, 1946, it had total assets of $2,488,836.53 and an earned surplus of $1,267,566.77. (R. 35, 52-54, 92.)

On December 16, 1946, the authorized capital stock of the corporation was increased from $150,000 to $650,000, represented by 6,500 shares of $100 par value common stock. On December 20, 1946, a stock dividend of common was declared and the corporation distributed five shares of common for each share of common outstanding, or a total of 5,012½ shares. The sum of $501,250 was accordingly transferred from earned surplus to capital account. (R. 54, 92.)

On December 26, 1946, the authorized capital of the corporation was increased to $1,452,000, represented by 8,020 shares of 4½ percent cumulative preferred stock, having a par value of $100, and 6,500 shares of common stock having the same par value. On December 28, 1946, a stock dividend of preferred was declared and the corporation distributed 1⅓ shares of preferred for each share of common outstanding, or a total of 8,020 shares. The sum of $802,000 was accordingly transferred from earned surplus to capital account. (R. 55-56, 92-93.)

Two days later the taxpayers, owning 8,000 of the preferred shares, agreed to sell 4,000 to the Lincoln National Life Insurance Company and 4,000 to the Northwestern Mutual Life Insurance Company. The purchase price was $100 per share, plus the amount of dividends accrued from November 1, 1946, to the date of delivery. On the same day the 8,000 shares were transferred to the insurance companies for $805,900. (R. 54-56, 58-60, 92-93.)

C. P. Chamberlin and the insurance companies engaged in negotiations before the distribution of the preferred stock. In entering into these negotiations Chamberlin was guided by a desire to save income taxes. The corpora-

tion had regularly made substantial distributions to the stockholders.[4] Chamberlin feared the tax consequences of any additional dividends because his income was already well into the highest bracket of 91 percent.[5] He was advised that the stockholders' tax burden would be less if the corporation distributed a dividend of preferred stock and the stockholders then sold the dividend shares to others. Both insurance companies made a detailed investigation of Metal Mouldings Corporation and carefully analyzed the terms of the proposed stock. No agreement of purchase was entered into until after the preferred shares were distributed to the taxpayers. (R. 53-54, 61-63, 93-95.)

The holders of the preferred shares were entitled to cumulative cash dividends in quarterly instalments beginning on November 1, 1946. The shares were subject to redemption on May 1, 1948, in an amount not exceeding 2,000 shares, and on May 1st of succeeding years in an amount not exceeding 1,000 shares. The precise amount to be redeemed depended upon the corporation's net earnings for the year preceding the redemption date. The corporation might, on any quarterly dividend date, redeem the preferred, in whole or in part, at par plus specified premiums and accrued dividends. If four quarterly dividends remained unpaid or if less than 500 shares were retired on each of any two annual retirement dates, the holders of the preferred were entitled to elect a majority of the directors. As long as any preferred shares were

---

[4] In 1942 the dividends were more than twice the corporation's net profits after taxes. In 1943 through 1945 the dividends aggregated $400,000 out of net profits after taxes totalling $887,172.35. (R. 54.)

[5] Apart from the asserted deficiency, Chamberlin reported a net income of $572,467.57 for 1946. (R. 11.) The combined normal tax and surtax for that year reached a maximum of 91 percent on any net income beyond $200,000. The total tax computed under the general schedule of rates was subject to a reduction of 5 percent. Revenue Act of 1942, § 102, 56 Stat. 802, amending Int. Rev. Code § 11.

outstanding, the corporation's net working capital could not be reduced below 150 percent of the value of the outstanding preferred shares or $750,000, whichever was greater; and the current assets could not be reduced below 200 percent of current liabilities. The consent of stockholders owning 75 percent of the preferred shares was required in order to change the articles of incorporation, to revise the capital structure, to sell substantially all the property, or to incur additional indebtedness beyond a stated amount. (R. 55, 94.)

In his return for 1946 each taxpayer reported the proceeds from the sale of his preferred stock as a net long-term capital gain, after subtracting the cost of the sale and the basis of the stock. (R. 63.) The Commissioner determined that the preferred stock was a taxable dividend, and that the value of the preferred was taxable as ordinary income. He further determined that the value of the preferred was the amount received on the sale. (R. 63.)[6] The Tax Court sustained the Commissioner's determination. (R. 64-73.) One judge concurred in the result in a separate opinion (R. 73-75); another judge concurred in the result without opinion (R. 73); and a third judge dissented (R. 75-78). The Court of Appeals unanimously reversed. (R. 91-103.)

---

[6] The Commissioner now says that he determined "that the amount received by each taxpayer constituted a dividend taxable as ordinary income." (Pet. 8.) But as both opinions below clearly indicate, the Commissioner actually determined that the preferred stock itself was a taxable dividend. In his notice of deficiency the Commissioner advised the taxpayers that it is the "value" of the preferred stock "received" from the corporation which "is taxable to you as a dividend." This was the very conclusion which the Tax Court also reached. (R. 52, 63, 64, 73.) Otherwise, the Tax Court would not have spent so much time on the proportionate interest rule relating to stock dividends. (R. 64-73.) See further p. 9, *infra*.

ARGUMENT

We respectfully submit that the decision of the Court of Appeals is clearly correct and does not present any special and important reason for a grant of certiorari. The decision rests securely on the statutes enacted by Congress and the decisions rendered by this Court. Indeed, the Commissioner is simply attempting to pry open a question which has long been closed.

1. Section 115(a) of the Internal Revenue Code provides that a dividend is "any distribution made by a corporation to its shareholders, whether in money or in other property," out of its earnings or profits after February 28, 1913. This general rule is qualified by a specific rule for stock dividends. Section 115(f)(1) states that a "distribution made by a corporation to its shareholders in its stock" is not to "be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution." The Treasury regulations add that the term "dividend" under Section 115(a) "does not include distributions" under Section 115(f), "relating to stock dividends." Regulations 111, § 29.115-1.

This Court has determined that certain stock dividends are not "income to the shareholder within the meaning of the Sixteenth Amendment." In *Eisner* v. *Macomber*, 252 U. S. 189 (1920), and *Helvering* v. *Griffiths*, 318 U. S. 371 (1943), the Court held that a dividend of common stock on common stock is not taxable income. In *Strassburger* v. *Commissioner*, 318 U. S. 604 (1943), the Court further held that a dividend of preferred stock on common stock, where only common stock is outstanding, is similarly not taxable. At the same time the Court ruled in *Helvering* v. *Sprouse*, 318 U. S. 604 (1943), that a dividend of non-voting common on voting common and non-voting common is also tax-free. All these decisions derive from the basic principle that a stock dividend is not taxable "within

the meaning of the Sixteenth Amendment" unless the distribution of the dividend alters the pre-existing proportionate interest of the stockholder. See further *Koshland* v. *Helvering*, 298 U. S. 441 (1936); *Helvering* v. *Gowran*, 302 U. S. 238 (1937). It is also settled that if dividend shares are non-taxable distributions, the stockholder does not realize any taxable gain until he sells the shares. See *Eisner* v. *Macomber, supra*, at 212; *Helvering* v. *Griffiths, supra*, at 375. The profit derived on a sale of the dividend shares is then taxable "as a gain derived through sale of some of the original shares would be." *Miles* v. *Safe Deposit Co.*, 259 U. S. 247, 253 (1922).

Congress has enacted and the Treasury has promulgated special provisions which govern the sale of dividend shares received in a non-taxable distribution. Section 113(a)(19)(A) declares that if a shareholder receives a stock dividend which is not taxable, "the basis of the new stock and of the old stock, respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock." The regulations meticulously indicate the method of allocation. They state that the basis is to be apportioned whether or not the stock dividend is "of a character or preference materially different from the stock in respect of which the distribution is made." Regulations 111, § 29.113(a)(19)-1, as correlated with § 29.113(a)(12)-1.

Section 117(h)(5) of the Code provides that if the basis of the dividend stock is determined under Section 113(a)(19)(A), "the period for which the taxpayer has held" the dividend stock includes "the period for which he held the stock in the distributing corporation" before the receipt of the dividend stock. Or, as the regulations express the same thought, "The period for which the taxpayer has held stock . . . issued to him as a dividend shall be determined as though the stock dividend . . . were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other

disposition of such stock dividend . . . is fixed by the apportionment of the basis of such old stock." Regulations 111, § 29.117-4. Finally, under Section 117(a) and (c) a gain realized on the sale of a capital asset held for more than six months is taxable as a long-term capital gain.

Each taxpayer correctly computed his taxes in the light of the statutes, regulations and cases. Since only common stock was outstanding when he received the preferred, the preferred was not a taxable dividend "within the meaning of the Sixteenth Amendment." *Strassburger* v. *Commissioner, supra.* See also *Stern* v. *Commissioner,* 32 A.F.T.R. 1737 (7th Cir. 1943), *rev'g* 46 B.T.A. 416 (1942); *Charles M. Cooke, Ltd.,* 2 T. C. 147 (1943). Cf. *Estate of Joseph E. Sorg,* 1 T.C.M. 879 (1943). Therefore, under Section 113(a)(19)(A) a portion of his basis for his common stock was allocable to his preferred stock; and under Section 117(h)(5) the holding period of his preferred stock included the holding period of his common stock. And so the Court of Appeals quite properly held that the sale of the preferred stock was a sale of a capital asset held for more than six months, and that the resulting profit was a long-term capital gain.

Again, the Court of Appeals correctly held that the desire to save taxes did not affect the conclusion. In the words of Judge Learned Hand, "a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it." Where "the transaction under scrutiny is in fact what it appears to be in form," it is immaterial whether the taxpayer sought "to avoid taxes, or to regenerate the world." *Chisholm* v. *Commissioner,* 79 F. 2d 14, 15 (2d Cir. 1935), *cert. denied,* 296 U. S. 641 (1935). It is the statute which counts. See *Commissioner* v. *Korell,* 339 U. S. 619 (1950). To borrow a felicitous phrase of Mr. Justice Holmes, "the standards of the law are external standards" (Holmes, The Common Law 110 (1881)), unless the statute itself indicates that "purpose or state of mind determines the incidence" of the tax.

See *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 289 (1938). Here no such subjective statute intrudes upon the controversy. The Commissioner has unintentionally illustrated what Judge Magruder has recently noted. While a desire to save taxes is not "rightly" significant, "it sometimes is permitted to give a spurious flavor" to an argument. *Channing* v. *Hassett*, 200 F. 2d 514, 516 (1st Cir. 1952).

2. The Commissioner evidently concedes that each taxpayer received a dividend of preferred stock; that he then contracted to sell the stock to the insurance companies; that he sold the stock in accordance with his agreement; and that the cash which he received was paid by the insurance companies. (Pet. 2, 6, 13.)[7] Cf. *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451 (1950). The Commissioner also concedes that a stock dividend is not taxable unless its receipt alters the stockholder's proportionate interest in the corporation. (Pet. 22.) In the Commissioner's own words, "whether such a dividend constitutes taxable income depends on whether it produces a change in the pre-existing proportionate interests of the stockholders." (Pet. 11.) And at no point does the Commissioner suggest that the taxpayers' receipt of the preferred shares changed their relative interests. Hence the Commissioner's quarrel with the Court of Appeals turns solely and precariously on a novel argument. He contends that a stock dividend which is otherwise nontaxable becomes taxable if the stockholder sells the dividend shares shortly after he receives them.[8] To summarize the

---

[7] The Commissioner's own witnesses testified that there was no agreement to sell the dividend stock until after its distribution. (R. 26, 28.)

[8] The Tax Court relied heavily on the equally novel argument that the stockholders' proportionate interests were altered by the eventual sale of the dividend shares. (R. 70-72.) The Court of Appeals easily disposed of this argument (R. 97), and the Commissioner has not revived it in his petition.

Commissioner's extraordinary position, the dividend shares would not have been taxable if they had not been sold, but they are taxable because they were sold.[9]

The Court of Appeals rejected this singular argument. "A non-taxable stock dividend," said the Court, "does not become a taxable cash dividend upon its sale by the recipient. On the contrary, it is a sale of a capital asset .... Obviously, if the non-taxability of a stock dividend rests solely upon the principle that it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of any of his holdings, the disposition of the stock dividend by the stockholder thereafter is not a factor in the determination." (R. 99.) Moreover, the Court added, the stock dividend cannot be taxed as if cash came from the corporation rather than the purchasers. The money received by each stockholder "was received from the insurance companies. It was not a 'distribution' by the corporation declaring the dividend, as required by the statute." (R. 100.)

This conclusion seems eminently correct. A distribution by a corporation consists of what the stockholder receives from the corporation. Section 115 of the Code plainly provides that a dividend is at the very least a "*distribution made by a corporation* to its shareholders."[10] See *Estate of Putnam* v. *Commissioner*, 324 U. S. 393, 399, 400 (1945);

---

[9] The Commissioner dwells at some length on the sales negotiations between Chamberlin and the insurance companies before the preferred stock was distributed to the taxpayers. However, we doubt whether the Commissioner regards the negotiations—apart from the sale itself—as adding much to his argument. If the issuance of a stock dividend does not alter the proportionate interest of a shareholder, his state of mind has no greater impact. Intention alone does nothing and changes nothing. Certainly the Commissioner is not saying that a sale of dividend shares has varying consequences, depending on whether the negotiations precede or follow the distribution of the shares. In both cases the results are precisely the same.

[10] Italics supplied.

Commissioner v. *Munter*, 331 U. S. 210, 214 (1947); *Commissioner* v. *Phipps*, 336 U. S. 410, 416, 419 (1949). "A stockholder does not pay for accumulated profits of his corporation unless he receives a dividend" (*Weiss* v. *Wiener*, 279 U. S. 333, 335 (1929)), and a "taxable dividend" is a "taxable corporate distribution." *Choate* v. *Commissioner*, 129 F. 2d 684, 687 (2d Cir. 1942). Or, as Mr. Justice Stone succinctly stated, "The distribution contemplated and defined" by Section 115 "as a dividend is one to be effected by corporate action." *Palmer* v. *Commissioner*, 302 U. S. 63, 71-72 (1937). By the same token, a distribution of stock by a corporation is something quite different from a sale of the stock by a shareholder. See *Eisner* v. *Macomber*, *supra*, at 212; *Helvering* v. *Griffiths*, *supra*, at 375. It is hornbook law that the proceeds realized by a shareholder on the sale of his stock are not a distribution from the corporation, whether the stock be original shares or dividend shares. See, for example, *Chapman* v. *United States*, 63 Ct. Cls. 106 (1927), *cert. denied*, 275 U. S. 524 (1927); *Insull* v. *Commissioner*, 87 F. 2d 648 (7th Cir. 1937); *Silas H. Burnham*, 29 B.T.A. 605 (1933); *Dodd, Mead & Co.*, 43 B.T.A. 739 (1941), *aff'd*, 123 F. 2d 145 (2d Cir. 1941); *Stanley D. Beard*, 4 T.C. 756 (1945); *Rodman Wanamaker Trust*, 11 T.C. 365 (1948), *aff'd*, 178 F. 2d 10 (3d Cir. 1949). Judge Arundell has concisely summarized the cases. A distribution consists of "what a stockholder receives from his corporation"—not what he may later receive from others. (R. 75.) The cases merely say what the Treasury itself has said. "Income resulting from the sale of stock received as a stock dividend is not the receipt of a dividend but gain or profit derived from the sale of stock." T.D. 4027, VI-1 Cum. Bull. 164 (1927). To the same effect see also G.C.M. 8751, X-1 Cum. Bull. 219 (1931).

It is equally settled that an early sale of dividend shares has no bearing on their taxability. *Insull* v. *Commissioner*,

supra; Silas H. Burnham, supra.[11] Cf. *Daisy M. Ward*, 29 B.T.A. 1251, 1254 (1934), *petition dismissed*, 79 F. 2d 381 (8th Cir. 1935); G.C.M. 8751, *supra*. As the Court of Appeals indicated, Congress has not drawn any distinction between a sale which quickly follows a distribution and a sale which is long delayed. Precisely the reverse is true. Congress has affirmatively declared that no such distinction is to be made. Section 117(h)(5) provides that if a shareholder receives a tax-free stock dividend, the holding period of the old shares is tacked on to the holding period of the new shares. This statute can only apply if the dividend stock is sold within six months after its receipt. Otherwise it serves no function at all.

If stock is held for more than six months, a profit realized on its sale is taxable as a long-term capital gain. If stock is held for a shorter period, a profit realized on its sale is taxable as ordinary income. Int. Rev. Code § 117(a)(b)(c). Obviously, if a shareholder receives a stock dividend which leaves his proportionate interest unchanged and holds the new stock beyond six months, he is entitled to capital gain treatment without the aid of Section 117(h)(5). The sole purpose of that provision is to tack on the holding period of the old shares where the new shares are sold within six months after they are received by the stockholder. The statute necessarily contemplates that a tax-free distribution of stock will often be followed by a quick disposition. Or to restate the same

---

[11] The Commissioner's position is particularly puzzling in the light of the *Burnham* decision. Since 1934 he has formally accepted that case as expressing the correct rule where stock dividends are expeditiously sold. XIII-1 Cum. Bull. 3 (1934). In the *Burnham* case the shareholders contracted to sell the dividend shares before they were received and they were sold on the same day that they were received. The Tax Court held that the stock dividend was non-taxable, and that the sale of the dividend shares in accordance with the prior contractual commitment was not a distribution of cash by the corporation. In the present case the stockholders did not enter into any agreement of purchase and sale until after the stock dividend was distributed.

assumption, Section 117(h)(5) presupposes that a distribution of stock does not become taxable merely because the shareholder is able to make an early sale.[12]

It is not difficult to isolate the source of the Commissioner's error. He is disturbed that a sale of non-taxable dividend shares enables a stockholder to pay a capital gains tax on proceeds which represent the stockholder's interest in accumulated earnings of the corporation. But any sale of stock in a prosperous corporation has the same effect, whether the stock consists of original shares or dividend shares, and whether the stock is sold sooner or later. These consequences inhere in the nature of stock as a financial symbol representing an aliquot interest in corporate capital and surplus. And whenever a corporation distributes a tax-free stock dividend, the equity reflected by the dividend may be realized through a sale, whether the stock is publicly held or closely held, and whether the stock is common or preferred.[13]

3. The Commissioner complains that the Court of Appeals substituted its own inferences of fact for those of the Tax Court. According to the Commissioner, the Tax Court found that the issuance of the preferred stock and

---

[12] Section 115(f)(2) of the Code is additionally illuminating here. This provision states that a stock dividend is not exempt from tax if the corporation also gave the stockholders an option to receive cash. Here, too, the emphasis is clearly on the cash which *the distributing corporation* makes available to its stockholders. Otherwise the status of non-taxability remains unimpaired. In *Eisner* v. *Macomber*, *supra*, at 211, 215, the Court pointed out that it was considering only *bona fide* or true stock dividends, as distinguished from optional stock dividends. In his dissenting opinion Mr. Justice Brandeis argued that both kinds should be treated alike. 252 U. S. at 220 *et seq.* But he did not remotely suggest the strange argument that proceeds derived on a sale of dividend shares may be taxed as a distribution by the corporation. At the very beginning of his opinion Mr. Justice Brandeis distinguished between the receipt of a stock dividend and a sale of "the new stock received as a dividend." *Id.* at 220. To him a dividend was something "received by a stockholder from a corporation." *Id.* at 226, 237.

[13] See also p. 24, *infra*.

the sale to the insurance companies were "interrelated component steps in a single prearranged transaction." On the other hand, the Court of Appeals allegedly "treated the issuance of the stock and the concurrent sale of it as if they were two independent transactions, each falling in a separate tax compartment." (Pet. 9-10, 23-24.) The Commissioner, we believe, has discovered a difficulty where none exists.

We readily agree, as the Tax Court held, that the receipt and sale of the dividend shares were not unrelated events, nor did the Court of Appeals in the least hold otherwise. The Court of Appeals specifically stated that the facts "are not in dispute" and it expressly accepted them as the Tax Court found them. (R. 92.) However, the Court concluded, as a matter of law, that an otherwise tax-exempt stock dividend does not become taxable merely because its receipt is quickly followed by a sale. (R. 97.)[14] This determination fell well within the province of the Court of Appeals—unless the Tax Court is to have the final say on the taxability of a stock dividend and the proceeds of its later sale. In short, the conclusion on appeal clearly derived from different "criteria for judgment" applied to the same "uncontroverted happenings." *Watts* v. *Indiana*, 338 U. S. 49, 51 (1949). The Tax Court relied on an erroneous standard of liability and, needless to add, its decisions are not binding where "the wrong standards for judgment have been applied." *Commissioner* v. *Culbertson*, 337 U. S. 733, 749 (1949). See also *Powers* v. *Commissioner*, 312 U. S. 259 (1941); *National Carbide Corp.* v. *Commissioner*, 336 U. S. 422 (1949); *Lilly* v. *Commissioner*, 343 U. S. 90 (1952). No one disputes that the terms of the preferred stock and the circumstances of its issuance were matters to be ascertained by the Tax Court. But it is equally true that the taxability of the dividend was "open

[14] As we have noted, the Tax Court held that the dividend shares themselves—and not the sales proceeds—were taxable as corporate distributions to the stockholders. See note 6, *supra*.

for determination" in the Court of Appeals, "unfettered by findings and rulings below except for the weight of the intrinsic authority of all lower court opinions." Frankfurter, J., in *Deputy* v. *du Pont*, 308 U. S. 488, 499 (1940). If the taxpayers had prevailed in the Tax Court, the Commissioner would hardly have urged that its decision was a mere inference of fact under Rule 52(a). We fail to see why his view should be different because he initially prevailed in the Tax Court and then lost on appeal. Whether a question is one of law or fact does not turn on whose foot is momentarily pinched.

4. In order to provide a basis for certiorari the Commissioner charges that the Court of Appeals failed to apply "the established principle that the substance rather than the form of a transaction is determinative of its tax effect." (Pet. 9.) This grievance cogently reveals the difficulties which the Commissioner has experienced in justifying his application to this Court.

As Judge Learned Hand has acutely noted, "such vague alternatives as 'form' and 'substance'" are "anodynes for the pains of reasoning." *Commissioner* v. *Sansome*, 60 F. 2d 931, 933 (2d Cir. 1932), *cert. denied*, 287 U. S. 667 (1932). They merely leave us on the threshold of the problem to be solved. Compare *United States* v. *Cumberland Public Service Co.*, *supra*, with *Commissioner* v. *Court Holding Co.*, 324 U. S. 331 (1945). The obligations of a taxpayer stem from the particular words used by Congress and not from some general homily available for all occasions. Taxation is a statutory subject, and any tax "asserted by the Commissioner" must be "authorized by Congress." *Helvering* v. *Griffiths*, *supra*, at 394.[15] Moreover, in tax cases, too, the meaning of a statute is not to be casually captured by some "seductive *cliché*." Cf.

[15] In any event, the Court of Appeals fully explored the Commissioner's argument in regard to "form" and "substance." No point which is now made was left untouched. (R. 98-102.)

Graves v. *N. Y. ex rel. O'Keefe*, 306 U. S. 466, 489 (1939). What we have just said is nicely illustrated by the Commissioner's argument. In the name of "substance" he has devoted a number of pages to various cases which have nothing to do with the statutes governing the taxability of stock dividends. Certainly, words and phrases on "form" and "substance," carefully culled from other areas of tax law, do not remotely indicate that the Court of Appeals' decision is "in conflict with applicable decisions of this court." Rule 38(5)(b) of Supreme Court Rules.[16]

The Commissioner's reference to *Bazley* v. *Commissioner*, 331 U. S. 737 (1947),[17] illustrates how far afield he has gone in seeking some ground for certiorari. The *Bazley* decision involved two closely held corporations. In both cases the stockholders exchanged their common stock, having a par value of $100, for new no-par common stock and debentures. The Commissioner taxed the debentures as a dividend. On the other hand, the taxpayers contended that the debentures had been received in a tax-free recapitalization under Section 112(g)(1)(E). This Court sustained the Commissioner.[18] It held that if each corporation had issued the debentures without a recapitalization, they would have constituted a taxable dividend. In the Court's view the result remained the same though there was also "an unrelated modification of the capital account." *Id.* at 742. It concluded that "nothing was accomplished that would not have been accomplished by an outright debenture dividend." *Id.* at 743.

The *Bazley* case is quite removed from the present context. There the only dispute was whether the stockholders

---

[16] Only recently, during this Term, the Court denied certiorari where the Commissioner similarly invoked the same generalizations about "form" and "substance" as a basis for the writ. Petition for a Writ of Certiorari, pp. 14-16, *United States* v. *Arcade Company*, 346 U. S. 828 (1953).

[17] Pet. 20.

[18] Mr. Justice Douglas and Mr. Justice Burton dissented.

had received a dividend. If the answer was yes, the dividend was plainly taxable because it consisted of debentures taxable as a distribution in kind. Int. Rev. Code, § 115(j); Reg. 111, § 29.115-10; *Doerschuck* v. *United States*, 274 Fed. 739 (E.D.N.Y. 1921). The stockholders' liabilities were simply appraised in terms of what they received from the corporation. Here, however, there is no dispute that each taxpayer received a dividend. The question, rather, is whether the receipt of the dividend altered his relative equity in the corporation under the controlling principle of proportionate interest. And in an effort to tax the receipt of the preferred stock, the Commissioner is erroneously attempting to appraise his liability in terms of what he later obtained from others than the corporation. But the application of the principle of proportionate interest turns on what the stockholder received from the corporation.[19] Under that principle the only relevant question is whether the corporate distribution of the stock dividend changed the shareholder's interest in relation to the other shareholders. If the answer is no, the special rules on basis and holding period apply to the sale of the dividend shares.[20]

---

[19] See p. 10, *supra*. The Commissioner somewhat emphasizes that the stock dividends had cash value upon issuance. He seems unaware that very few tax-free stock dividends, if any, ever lack cash value. If the Commissioner's view is well taken, he should also have taxed the common stock dividends which preceded the distribution of the preferred.

[20] The Commissioner's reference to *Gregory* v. *Helvering*, 293 U. S. 465 (1935), again illustrates how far off he is from the beaten track of this case. There the taxpayer effected a transfer of property to a corporation which was not intended to function or to obtain true rights in the property. The whole purpose "was merely to draught the papers." *Chisholm* v. *Commissioner*, *supra*, at 15. Here, on the other hand, the taxpayers transferred stock to independent buyers in an arm's length deal and the stock was undeniably a true equity. The reality of a corporate security is easily indicated by the "demonstrated possibility of sales" to "persons other than the stockholders." Cf. *John Kelley Co.* v. *Commissioner*, 326 U. S. 521, 525-526 (1946).

5. The Commissioner repeatedly insists that since the preferred stock was quickly sold after it was received, he may tax the distribution of the stock *as if* the stockholders had received cash from the corporation. In other words, he assumes that he may revise legal transactions because one follows the other in relatively rapid succession. But in the absence of a special dispensation the Commissioner is no less restrained than taxpayers in conjuring tax consequences out of imaginary transactions. For as Mr. Justice Brandeis pointed out, tax cases are not decided in response to transactions which never occurred. See *Founders General Co.* v. *Hoey*, 300 U. S. 268, 275 (1937). The decisions of this Court leave little to be said on the Commissioner's philosophy of "as if."[21]

In *General Utilities Co.* v. *Helvering*, 296 U. S. 200 (1935), a corporation owned securities which had appreciated in value. A prospective buyer desired to acquire them. The corporation indicated that the securities could be bought only after distribution to its stockholders, "since a sale by it would subject the realized profit to taxation, and when the proceeds passed to the stockholders there would be further exaction." 296 U. S. at 202. After the terms of sale were fairly clear, most of the securities were distributed as a dividend in kind to the stockholders, who then entered into a written agreement to sell them. The Government asserted a deficiency against the corporation, and argued, among other things, that the transfer to the stockholders should be ignored. According

---

[21] We need not speculate as to the reactions of the Commissioner if a taxpayer boldly declared that he should be taxed on the basis of facts which failed to occur. The answer would then be—and properly so— that his liability must be determined on the basis of what was done and not what might have been done. Any attempt to apply a philosophy of "as if" would be criticized and deplored. See, e.g., *Founders General Co.* v. *Hoey, supra; Jeffries* v. *Commissioner*, 158 F. 2d 225 (5th Cir. 1946), *cert. denied*, 330 U. S. 843 (1947); *Wall* v. *United States*, 164 F. 2d 462 (4th Cir. 1947); *Estate of Elise W. Hill*, 10 T. C. 1090 (1948).

to the Government, the sale was made "in substance" by the corporation, "through the stockholders as agents or conduits through whom the transfer of the title was effected. The stockholders, even in their character as agents, had little or no option in the matter and in no sense exercised any independent judgment."[22] This Court held that the record afforded "no support whatever" for the attempt to treat the corporation as the seller.[23] "To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause." *Id.* at 207.[24]

In *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481 (1937), this Court again dealt with the tax incidence of successive transactions. The case involved five stockholders, an old corporation and a new corporation. Two of the stockholders planned to continue operations in the new corporation and the other three planned to retire. In accordance with their joint understanding, the three assigned their stock to the remaining two; the old corporation assigned its assets to the new corporation; the

---

[22] This language is taken from the opinion of the Fourth Circuit, which sustained the Government. *Id.* at 205-206.

[23] The Court also held that the argument had been improperly raised.

[24] Cf. *Chisholm* v. *Commissioner*, *supra*, where two brothers transferred property to a newly formed partnership, which promptly sold the property as the brothers might have sold it. The Government argued that the first transfer should be disregarded, and that the sale should be taxed as if the brothers had sold the property and then contributed the proceeds to the partnership. The Second Circuit disagreed in an opinion written by Judge Learned Hand. In his discussion he carefully explained that the determinative element in the *General Utilities* case was whether the shareholders "were under legal liability to complete" a bargain made by the corporation. For "if they were free to choose whether or not to perform the company's contract, the company had not sold." 79 F. 2d at 16. The Second Circuit's analysis preceded and anticipated this Court's decision in the *General Utilities* case, which reversed the Fourth Circuit. See further the cogent summary in *Starr* v. *Commissioner*, 82 F. 2d 964 (4th Cir. 1936), *cert. denied*, 298 U. S. 680 (1936).

five stockholders assigned their individual properties to the new corporation; and the old corporation dissolved. In assigning their stock the retiring stockholders stipulated for a return of their shares if the transfer of assets to the new corporation failed to materialize. The question was whether the transfer from the old corporation to the new corporation was a tax-free reorganization under the Revenue Act of 1918. The Commissioner sought to resolve this question in the negative. He argued, among other things, that the old stockholders had in effect sold their stock to the new corporation for cash. In support of this view the Commissioner maintained that the prior assignment of the stock to the remaining stockholders "constituted a single indivisible transaction." *Id.* at 496. The Court held that the facts were otherwise and that the Commissioner could not rearrange the terms of the transactions to suit himself. The stipulation for a return of the stock "did not make the two sales a single or indivisible transaction." Even if the three stockholders "would not have sold their Tex-Penn stock without also selling" their individual properties, "that fact would not convert the two sales into one." *Ibid.*

The Court made the same point once more in *United States* v. *Cumberland Public Service Co., supra.* There the stockholders of the taxpayer wished to dispose of its assets at the least cost in tax. A prospective buyer offered to acquire the assets from the taxpayer. The offer was rejected because the taxpayer "would have been compelled to pay a heavy capital gains tax." In order to avoid this burden the stockholders offered to sell the assets after liquidating the taxpayer. The buyer agreed; the taxpayer was liquidated; and the stockholders transferred the distributed assets in accordance with "the previously contemplated sale." 338 U. S. at 452-453. The Government contended that the corporation had really made the sale, but its argument easily failed. The Court held, in an opinion by Mr. Justice Black, that the stockholders were

the sellers and that the reality of their transaction was unimpaired by "a major motive" to reduce taxes. The Government could not reconstruct the transaction because the liquidation before the sale failed to serve any business purpose. Under the statute "a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet is not taxed if that property is distributed in kind and is then sold by the shareholders." The only significant question is whether the corporation or its shareholders have made the sale. True, "in both instances the interest of the shareholders in the business has been transferred to the purchaser." But the diversities in incidence are "inherent in the present tax pattern," and the pattern cannot be ignored because the taxpayers are aware of the diversities. *Id.* at 455-456. See also *Steubenville Bridge Co.*, 11 T.C. 789, 798 (1948).

These and many other cases[25] are variations on a common theme. The Commissioner cannot change transactions in order to achieve desired tax consequences. The same prohibition equally applies though one transaction rapidly follows another and the ultimate effect would have been identical if the taxpayer had consummated a different series of transactions. Obviously, in the *General Utilities, Tex-Penn*, and *Cumberland* cases the final result would have been no different if the taxpayers had planned their transactions to suit the preferences of the Commissioner. As the Tax Court has stated, it is beyond argument "that tax consequences are frequently very different under one state of facts from what they are under another state of facts." *Estate of Emanuel Ulman*, 46 B.T.A. 517, 526 (1942), *aff'd sub nom Citizens & Southern Nat. Bank* v. *Commissioner*, 136 F. 2d 406 (5th Cir. 1943), *cert. denied*, 320 U. S. 752 (1943). See also *Woodruff* v. *Commissioner*, 131 F. 2d 429 (5th Cir. 1942). A taxpayer is not morally obliged to choose

[25] See, e.g., *United States* v. *Cummins Distilleries Corp.*, 166 F. 2d 17 (6th Cir. 1948); *Chisholm* v. *Commissioner*, *supra*.

the course which the Commissioner would be inclined to favor. *Commissioner* v. *Gilmore's Estate*, 130 F. 2d 791, 795 (3d Cir. 1942).

For that matter, in the present case the Commissioner has done little more than re-argue the *Cumberland* case. His brief here largely echoes his brief there. In that case he methodically described the liquidation "as a form to cloak a sale of the corporation's property," and as "a meaningless step whereby there was a circuitous routing of title to the ultimate purchaser, the stockholders acting as pure conduits." Brief for the United States, p. 9, in *United States* v. *Cumberland Public Service Co., supra.* See also *id.* at 10, 13. "The liquidation distribution" was supposedly "only a step in an integrated plan to accomplish, somewhat deviously, the desired end, namely, the transfer to the intended purchaser. It was a meaningless gesture, except as it sought to achieve a different tax result and to place a different complexion on what would have been the situation if the passage of title had taken a less circuitous route from the corporation to the purchaser." *Id.* at 17-18. There also the Commissioner insisted that it was immaterial who negotiated and made the sale. *Id.* at 26. And he similarly cited and quoted the opinions in *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609 (1938),[26] and *Commissioner*

[26] In *Minnesota Tea Co.* v. *Helvering, supra*, the taxpayer assigned its assets to another company in exchange for the latter's stock and cash. The taxpayer transferred the cash to its stockholders, who assumed the obligation to pay its debts and then paid them. Under the governing statute a corporation was not taxable on any gain attributable to cash received in a reorganization if the cash was "distributed" to its stockholders. The Court held that the cash used to pay the taxpayer's debts was not "distributed" to the stockholders within the meaning of the statute. They received that amount, "not as a distribution for their benefit but as a fund the equivalent of which they were bound to pass on, and did pass on, to the creditors." *Id.* at 613. The Court simply applied the statute in the light of the substantive obligations actually created by the parties. There was no attempt to determine the tax consequences on the basis of some hypothetical or reconstructed transaction.

v. *Court Holding Co., supra.*[27]

Yet the Commissioner is not afraid to be inconsistent. He reasons quite differently where a cash dividend is followed, pursuant to an overall plan, by the stockholder's acquisition of additional stock. Then the Commissioner correctly contends that the corporation has made a taxable distribution of cash, regardless of the quick purchase of stock which produces an effect akin to a non-taxable distribution of stock. According to the Commissioner, "It is the inherent nature of the dividend itself that controls." *Lonsdale* v. *Commissioner*, 32 F. 2d 537, 539 (8th Cir. 1929), *cert. denied*, 280 U. S. 575 (1929). See also *Mrs. Frank Andrews*, 26 B.T.A. 642 (1932). The Court of Appeals properly concluded that the same view applies to stock dividends. This conclusion is easily supported by the facts here, for the Tax Court found that each taxpayer received preferred stock and then sold it as his own. As the Second Circuit declared in a cognate situation, "whether the transaction is viewed as a whole or as a series of separate steps," he fully enjoyed "freedom of action after he acquired the stock." "It is immaterial how soon thereafter he elects to dispose of his stock by gift or otherwise," though his election conforms to "a preconceived plan." *Wilgard Realty Co.* v. *Commissioner*, 127 F. 2d 514, 516 (2d Cir. 1942).

---

[27] The Commissioner quotes a portion of the *Court Holding* opinion which involved a different problem relating to findings of fact where diverse inferences are permissible. (Pet. 16.) The language in question was addressed to the point that "in resolving such questions as who made a sale, fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what appears in written instruments used by parties to control rights as among themselves." But once the content of a transaction is determined, motive is immaterial in determining the legal consequences which attach to that content. See *United States* v. *Cumberland Public Service Co., supra*, at 454-455. In the present case the triers of the facts have determined that the taxpayers received a pro rata dividend of preferred shares and then transferred them to the insurance companies. The only question in the Court of Appeals was whether the Tax Court had applied correct principles of law. See p. 13, *supra*.

6. The Commissioner's argument is no less than a disguised attempt to ignore this Court's decision in *Helvering* v. *Sprouse, supra,* and *Strassburger* v. *Commissioner, supra.* In attempting to prevail in those cases, the Commissioner maintained that the stock dividends were taxable because they could be sold for cash. In the *Sprouse* case the Government argued: "Prior to the receipt of the stock dividend the respondent owned only voting stock, but the distribution of the stock dividend constituted a readjustment of the corporate structure such that he could sell his non-voting stock and still retain the same control over the enterprise. This new stock represented corporate earnings convertible into cash by sale without diminishing the respondent's basic interest any more than would have been the situation in the *Koshland* case had the stockholder there sold the stock dividend." Brief for the Petitioner, pp. 5-6. In the *Strassburger* case the argument was the same. The "important fact," said the Government, "is that the distribution of a new kind of stock gives the recipient rights which are of a different character from those which he previously owned." "Since the new stock carries no voting rights it might be disposed of without affecting petitioner's control of the corporation. It carries with it the right to the payment of a fixed annual amount before dividends may be paid upon the common stock, and this right is cumulative. All of these new rights may be disposed of without affecting the petitioner's pre-existing interest as the holder of the common stock." Brief for the Respondent, pp. 45, 46.

The Commissioner's failure to persuade this Court in the *Sprouse* and *Strassburger* cases[28] is significantly re-

[28] In discussing the *Strassburger* case the Commissioner implies that there the taxpayer intended and continued to hold the dividend shares. However, the facts were different. The apparent purpose of the dividend was to enable the shareholder to make a gift to his wife, and he gave her the newly issued shares five days after he received them. *Emil H. Strassburger,* 1941 P.-H. B.T.A.

vealing here. In both cases the Commissioner argued that the stock dividends should be taxed because they could be expeditiously sold. In rejecting this argument the Court was fully aware that stock dividends are commonly sold after they are received. One of the usual reasons for declaring a stock dividend is to enable the stockholders to sell some of their holdings. Obviously, the decisions in *Eisner* v. *Macomber, supra,* and *Helvering* v. *Griffiths, supra,* would not have been different if the declaration of the dividend had been designed to expedite a sale of dividend shares and if the receipt of the shares had been quickly followed by their sale. Having lost those cases, as well as the *Sprouse* and *Strassburger* cases, the Commissioner now argues that stock dividends which are otherwise tax-free become taxable if they actually are sold. Instead of seeking Congress' assistance if he is dissatisfied, the Commissioner proceeds to sabotage this Court's opinions.

7. The Commissioner does not claim that the decision below is in conflict with a decision of another Court of Appeals.[29] Nor does the decision below raise an important question of law which deserves this Court's special scrutiny. In this connection, the Commissioner does not assert that the decision creates any serious administrative problems for him in the disposition of other pending cases. He merely states that he expects future attempts to minimize

---

Memo. Dec. ¶ 41,098. In arguing the *Strassburger* case in this Court, the Commissioner expressly noted that the gift of the dividend rapidly followed its receipt. See Brief for the Respondent, p. 3.

[29] The Commissioner mentions several articles to vindicate his petition. (Pet. 24, n. 6.) Needless to say, articles do not authorize a tax which the Commissioner cannot otherwise justify. However, quite apart from this difficulty, the Commissioner's reference to the articles is less than accurate and complete. The articles leave no doubt that he has wandered well beyond the relevant statutes and far into the domain of policy where only Congress is free to tread.

tax through stock dividends.[30] But future problems are not the kind of present questions which the writ of certiorari was designed to bring here. See *Brown* v. *Allen*, 344 U. S. 443, 491 (1953). And since whatever difficulties the Commissioner may fear are still in the future, he may seek appropriate legislation in Congress rather than burden the courts with complex issues of tax policy. Certainly this Court does not sit to resolve the Treasury's anticipatory administrative problems. The Court's sensitive concern with only those questions which are both immediate and significant is peculiarly fitting amid the endless complexities of tax law. For, as Mr. Justice Reed has so aptly stated, "Judicial efforts to mold tax policy by isolated decisions make a national tax system difficult to develop, administer or observe." *Commissioner* v. *Estate of Church*, 335 U. S. 632, 653 (1949).

---

[30] The Commissioner quotes from a letter which his Chief Counsel has written to the Department of Justice. (Pet. 24, n. 6.) This letter does not improve his case for certiorari. The quoted excerpt alludes, in somewhat cloudy fashion, to a so-called "accepted tax policy of the last five years." Apparently the Commissioner is referring to the policy which he pursues when taxpayers request advance rulings on proposed stock dividends. In the last five years he has refused to rule in advance that the profit realized on a sale of preferred stock dividends is capital gain. On the other hand, he has repeatedly so ruled in regard to sales of common stock dividends, whether voting or non-voting. See Darrell, *Recent Developments in Nontaxable Reorganizations and Stock Dividends*, 61 Harv. L. Rev. 958, 961 (1948). We fail to see how the Commissioner's policy with respect to advisory rulings creates a present and important question for adjudication here. The issuance of advance rulings is purely a matter of discretion, which the Commissioner may or may not exercise in the light of various considerations. See Rev. Rul. 10, 1953-2 Cum. Bull. 18; Mim. 4963, 1939-2 Cum. Bull. 459. For example, he may wish to discourage certain transactions despite the absence of legislation by Congress. The Commissioner often refuses to give favorable advisory rulings though the taxpayer would easily succeed in the courts. Surely where the exceptional writ of certiorari is involved, the Commissioner cannot lift himself by his own bootstraps by declining to issue requested rulings.

Moreover, there is no question here which the Court can definitively determine in favor of the Commissioner. Under the statutory scheme devised by Congress a stock dividend is clearly non-taxable if it does not alter the stockholder's proportionate interest, and the profit derived on a sale of the dividend is clearly a capital gain. If for some reason this Court were to hold differently in this case, the lower courts would then have to determine whether a case fell within the established rule or within the newly found exception. Inevitably the Treasury and the courts would be left to struggle in a morass of confusing particularities.

As this Court's decisions readily disclose, the Treasury has struggled with stock dividends almost thirty-five years since *Eisner* v. *Macomber*. The decisions were rendered "after mature consideration"; they were "designed to fashion the governing rule of law"; and they have become the basis for a complex network of subsidiary rules.[21] Cf. *Screws* v. *United States*, 325 U. S. 91, 112 (1945). And see *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469, 487 (1940); *Helvering* v. *Griffiths*, *supra*, at 402; *Walling* v. *Halliburton Co.*, 331 U. S. 17, 25 (1947); *Toolson* v. *New York Yankees*, 346 U. S. 356, 357 (1953). Throughout all the years since *Eisner* v. *Macomber* it has been settled that if a stock dividend does not change a stockholder's proportionate interest, the profit obtained on a sale of the dividend shares is taxable as a capital gain. Otherwise the Treasury would not have labored so hard and so long to tax stock dividends as ordinary income. Though almost eleven years have passed since this Court last spoke on stock dividends,[22] the Treasury has conspicuously failed to request any legislation which would treat stockholders differently. Yet during this same period Congress and the Treasury have

---

[21] See Int. Rev. Code §§27(b)(f)(i), 102(d)(2), 113(a)(19)(A), 115(f)(h), 117(h)(5), 335, 362(b)(2), 441(d), 458(d)(f), 504(a)(c), 506(c).

[22] *Helvering* v. *Sprouse*, *supra*, and *Strassburger* v. *Commissioner*, *supra*.

been unusually occupied with tax legislation. Congress has enacted six major tax revisions[33] and other significant amendments.[34] These have included many important changes actively sponsored by the Treasury in order to safeguard the revenues. But despite all the intense legislative activity, the Treasury has steadfastly refrained from asking Congress to reconsider the taxability of proceeds from the sale of stock dividends. At the same time the Treasury has continued to promulgate regulations which articulate the established rules. Regulations 111, §§ 29.113 (a)(19)-1, 29.117-4; Regulations 118, §§ 39.113(a)(19)-1, 39.117(h)-1(b).

The matter does not end there. After an exhaustive study of stock dividends the Committee on Ways and Means has just proposed a remedy for the avoidance which the Commissioner seems to fear. The Committee plans to impose a special "85 percent transfer tax on the corporation" if the dividend shares, after sale, are redeemed within ten years from the date of issuance. The corporation will be taxable at the time of redemption. For the convenience of the Court we set forth the relevant portions of the Committee's analysis and recommendation in Appendix B, *infra*.

For present purposes the Committee's statement is especially illuminating in several respects. First, it indicates that whatever problem exists is plainly for Congress to solve. Only a statute can properly cope with the many intricacies involved. Second, the Committee eliminates any doubt, if any doubt remains, in regard to the correct-

---

[33] Revenue Act of 1943, Pub. L. No. 235, 78th Cong., 2d Sess. (1944); Individual Income Tax Act of 1944, Pub. L. No. 315, 78th Cong., 2d Sess. (1944); Revenue Act of 1945, Pub. L. No. 214, 79th Cong., 1st Sess. (1945); Revenue Act of 1948, Pub. L. No. 471, 80th Cong., 2d Sess. (1948); Revenue Act of 1950, Pub. L. No. 814, 81st Cong., 2d Sess. (1950); Revenue Act of 1951, Pub. L. No. 183, 82d Cong., 1st Sess. (1951).

[34] See, *e.g.*, Technical Changes Act of 1949, Pub. L. No. 378, 81st Cong., 1st Sess. (1949); Technical Changes Act of 1953, Pub. L. No. 287, 83d Cong., 1st Sess. (1953).

ness of the decision below. It expressly states that the stock dividend "was not a taxable distribution under existing Supreme Court decisions." Indeed, the Committee intends to continue the present capital gain treatment for stockholders, whether the sale of the stock dividend is prompt or delayed. Third, the proposed solution is a new tax on the corporation rather than the stockholders. In other words, the Committee has refused to impose by legislation the very tax which the Commissioner is now attempting to impose by judicial decision. Fourth, in view of the contemplated legislation, this Court would only labor in vain if it granted certiorari. Even if we rashly assume that the decision below is erroneous, a reversal would not provide any meaningful rule for the future. On the contrary, the decision would be overruled by the legislation.

Few areas in tax law are enmeshed in more defiant difficulties than capital gains and stock dividends. And no technical problems in taxation require a more profound inquiry into "questions of legislative policy bearing on fiscal and economic matters and on administrative convenience." Cf. *Commissioner* v. *Beck's Estate*, 129 F. 2d 243, 246 (2d Cir. 1942). If there are any doubts on this score, we need only refer to the Herculean labors of the American Law Institute. See A. L. I. Federal Income Tax Statute, p. 224 *et seq.* (Tent. Draft No. 7, 1952). In the Institute's view no adequate treatment of stock dividends is possible unless Congress abandons the principle of proportionate interest as the controlling standard of liability.[35] But as the Institute additionally emphasizes, no alternative scheme of taxation is feasible unless Congress also unravels a formidable group of intricate problems in policy and draftsmanship. Courts "have no power to embark on such an enterprise," nor do they have the facilities to succeed. Un-

[35] Under the comprehensive amendments contemplated by the Ways and Means Committee practically all stock dividends would be non-taxable, regardless of whether they alter the stockholders' proportionate interests, and as a result the profit realized on their sale would qualify as capital gain. See Appendix B, *infra*.

like Congress, they may not "roam at large, confined only by the Constitution." *Commissioner* v. *Beck's Estate, supra,* at 245, 246.

The existing provisions on stock dividends are rooted in interrelated premises and policies which Congress has approved and which only Congress can change. "If in practice these sections are causing such loss of revenue as to indicate that Congress may have erred in its balancing of the competing considerations involved, the amendment must obviously be enacted by the Congress and not the Commissioner of Internal Revenue or this Court." *Commissioner* v. *Korell, supra,* at 626. This Court's similar response in *United States* v. *Nunnally Investment Co.,* 316 U. S. 258 (1942), is still more appropriate here. As the Court stated, "such a determination of policy in the administration of the income tax law should be made by Congress, which maintains a Joint Committee on Internal Revenue Taxation charged with the duty of investigating the operation of the federal revenue laws and recommending such legislation as may be deemed desirable." Congress alone "can deal with the matter comprehensively, unembarrassed by the limitations of a litigation involving only one phase of a complex problem." *Id.* at 264. See also *Helvering* v. *Gowran, supra,* at 241-243.

CONCLUSION

The opinion of the Court of Appeals is a thoughtful and painstaking analysis of all the issues in the case. The decision is correct, there is no conflict of decisions, and no question remains to absorb this Court's time and attention. The petition for writs of certiorari should therefore be denied.

Respectfully submitted,

RANDOLPH E. PAUL,
Counsel for the Respondents.

LOUIS EISENSTEIN,
Of Counsel.

APPENDIX A

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of property.*—The basis of property shall be the cost of such property; except that— • • •

(19) *Property acquired by corporate stock distribution.*

(A) If the property was acquired by a shareholder in a corporation and consists of stock in such corporation, or rights to acquire such stock, acquired by him after February 28, 1913, in a distribution by such corporation (hereinafter in this paragraph called "new stock"), or consists of stock in respect of which such distribution was made (hereinafter in this paragraph called "old stock") and • • •

(ii) the new stock was acquired in a taxable year beginning after December 31, 1935, and its distribution did not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution;

then the basis of the new stock and of the old stock, respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock; such allocation to be made under regulations which shall be prescribed by the Commissioner with the approval of the Secretary.

• • • • • •

(26 U.S.C., 1945 ed., Sec. 113.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter • • • means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed

as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. • • •

• • • • • • •

(f) *Stock Dividends.*—

(1) *General rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

• • • • • • •

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

• • • • • • •

(26 U. S. C., 1945 ed., Sec. 115.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—• • •

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;[1]

• • • • • • •

(h) *Determination of Period for Which Held.*—For the purpose of this section—

• • •

(5) In determining the period for which the taxpayer has held stock or rights to acquire stock received upon a distribution, if the basis of such stock or rights is determined under section 113 (a) (19) (A), there shall

[1] This provision is quoted as it read before amendment by Revenue Act of 1951, § 322(c)(2), 65 Stat. 500.

(under regulations prescribed by the Commissioner with the approval of the Secretary) be included the period for which he held the stock in the distributing corporation prior to the receipt of such stock or rights upon such distribution.

* * * * * * *

(26 U. S. C., 1945 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec 29.113(a)(12)-1. *Basis of Property Established by Revenue Act of 1932.*—* * *

(2) If the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or if the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security to which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provisions, securities are different in class from stocks and stocks or securities in one corporation are different in class from stocks or securities in another corporation. In general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

* * * * * * *

Sec. 29.113(a)(19)-1. *Basis of Stock and Rights Involved in the Acquisition of Stock Dividends or Stock Rights: General Rules.*—(a) *Stock dividends.*—In the

case of stock * * * in respect of which was acquired in a taxable year beginning after December 31, 1935, a stock dividend which did not constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution, the basis for determining gain or loss from a sale or other disposition of either the stock in respect of which the distribution was made or the stock dividend shall . . . be ascertained in accordance with the principles set forth in section 29.113(a)(12)-1.

* * * * * *

Sec. 29.115-1. *Dividends.*—* * *

The term "dividend" does not include distributions under * * * section 115 (f), relating to stock dividends * * *.

* * * * * *

Sec. 29.117-4. *Determination of Period for Which Capital Assets are Held.*—* * *

The period for which the taxpayer has held stock * * * issued to him as a dividend shall be determined as though the stock dividend * * * were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other disposition of such stock dividend * * * is fixed by the apportionment of the basis of such old stock.

* * * * * *

APPENDIX B

General Tax Revision[1]

Committee on Ways and Means: Chairman Reed announced that the following substantive changes were agreed to during today's consideration of the general revenue revision bill for 1954—

Corporate Distributions and Adjustments

Adopted a series of provisions which substantially revise the tax treatment of corporate distributions and adjustments. These changes are designed to provide a more orderly treatment of these problems. Some of the more important features of the new provisions of the committee proposals are discussed below.

1. *Corporate distributions of stock.*—Under present law it is clear that a stock dividend of common stock on common stock is not taxable as a dividend. The tax treatment of other types of stock distributions, however, is uncertain. The committee, to clarify the tax treatment of these other distributions, adopted a provision allowing a corporation to distribute tax free its own stock (or rights to this stock) to the greatest possible extent. In general all distributions made by a corporation of its own stock are to be tax free unless they are in lieu of payments for dividends on preferred stock or interest on bonds. Where a stockholder has a choice between receiving money or stock, any stock distributions are to continue to be taxable as under existing law.

2. *Preferred stock "bail out."*—The committee acted to prevent tax avoidance which otherwise might occur as a result of the recent court decision in the Chamberlin case. In this case a dividend in preferred stock was declared to a stockholder who controlled the company. This was not a taxable distribution under existing Supreme Court deci-

[1] 100 Cong. Rec. D76 (Jan. 28, 1954).

sions. The preferred stock was sold by the stockholder to another person and the corporation immediately redeemed the preferred stock for cash.[2] In effect, the stockholder received a share of the earnings and profits of the corporation, but, instead of being taxed at ordinary tax rates on these earnings, paid only a capital gains tax. The Committee adopted a provision which stops this avoidance device by imposing an 85-percent transfer tax on the corporation at the time it redeems the preferred stock within 10 years of the time the stock was issued unless—(a) the redemption was made in liquidation (complete or partial) of the corporation; (b) at the time of the redemption of the stock there is a proportionate redemption of the stock on which the preferred stock was issued; (c) the redemption was of preferred stock issued for a contribution of property (but then only to extent of 105 percent of the value of the property); (d) the redemption is treated as a dividend; or (e) the redemption is made to pay death taxes.

* * * * * *

[2] This sentence is not entirely correct. The preferred stock in this case was gradually redeemable over 7 years and 4 months if profits were available, and the first redemption did not take place until 1 year and 4 months after issuance of the stock.